THRASHER ANALYTICS

Two Things I Want to See Before Turning Bullish

Equities are now down over 25% for 2019 and I'm on the hunt for good news. I wish I had some. Market internals, as I discussed last weekend, continue to look bearish and there's not signs yet of bullish rotation in sectors and risk appetite has yet to materially strengthen. In my last letter I shared my findings of studying the past bear markets and major declines in equities, with most ending in a complex bottoming process rather than a V-shaped bottom. The next step in my thought process is methods to identify that initial low or final low based on the characteristics that are associated with an improving market environment.

Two primary focuses of technical analysis involve breadth and momentum. During healthy markets, momentum takes the focus but during times like these, I focus more on the breadth of the market – tracking what individual stocks are doing. We're unlikely to see a low in the major indices until their individual components improve. As prices continue to trend lower, I'm building my check list of what I want to see to get more comfortable taking on equity risk and get confident that the darkness has broken. There are several indicators I share with you in each letter, Risk Appetite, Volatility-adjusted Momentum, Sector Leadership, Risk On/Off, Volatility Risk Trigger, to name a few. These all will play a roll in getting a clearer picture of what's transpiring in the financial markets.

As we move further from the top, hopefully we are moving closer to the bottom. When will that happen? No one knows. What we can know is what we are on the lookout for as signs it's come. There's two key pieces of data I'm looking for to get confidence a low has occurred or is very near. I want to see both of these in the market. To be clear,

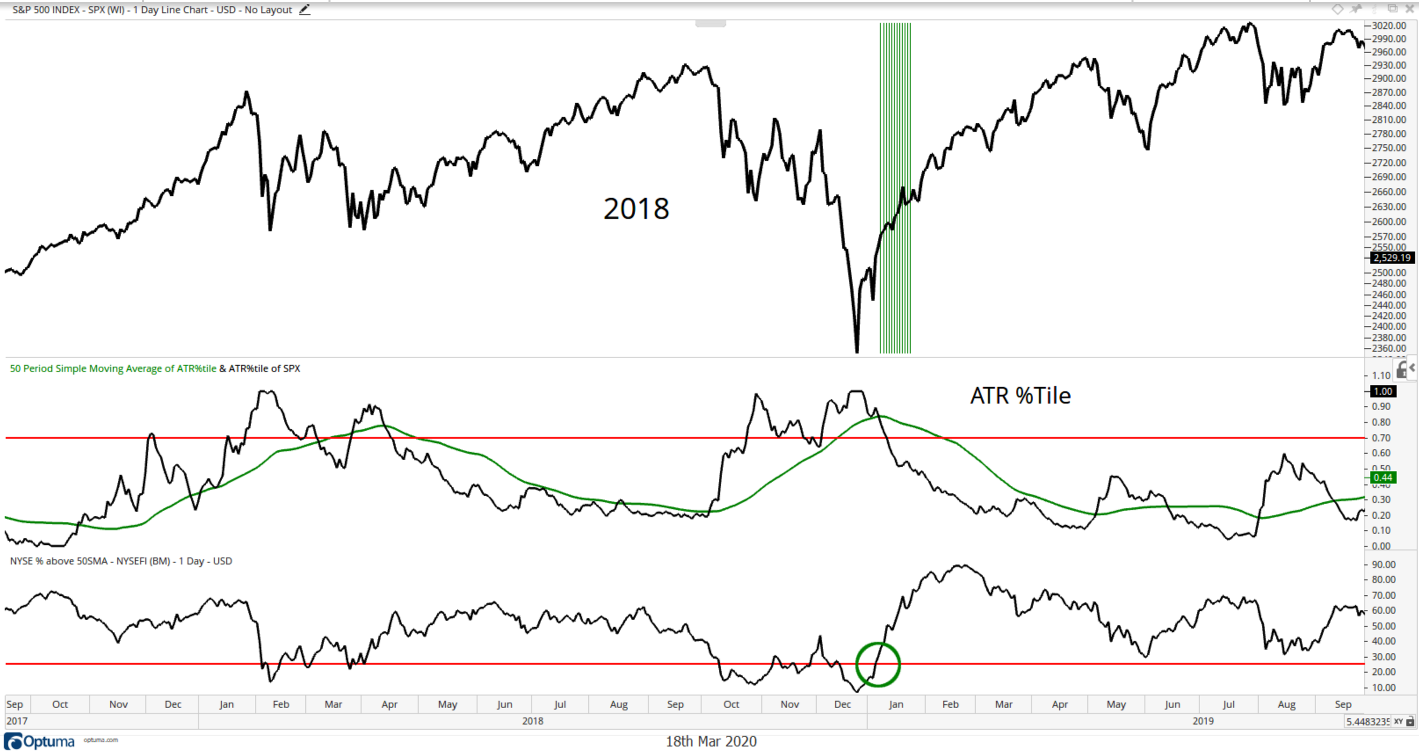
The First:
Volatility needs to calm down. We need to stop having circuit breakers triggered on both down and up days. When I say volatility, I don't mean the VIX which is an expectation of future volatility, but the literal ups and downs being experienced in equities presently. While strength in equities is welcomed, the kind of moves higher we're occasionally seeing right now aren't characteristics of a healthy market. Some of the best days often follow the worst. I want to see large swings diminish.

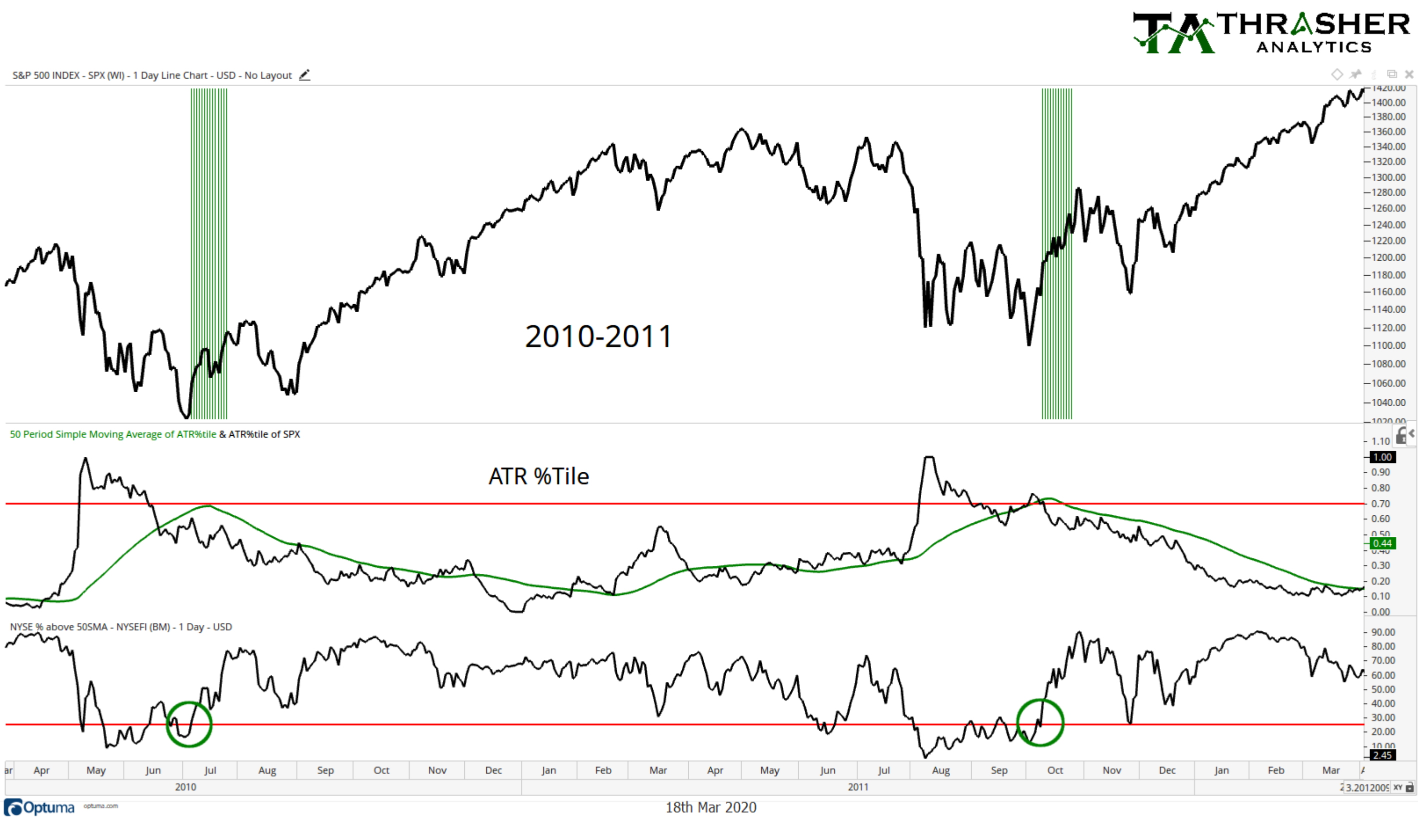
There are several ways to measure this, my preference is using a simple Average True Range. The next question becomes what kind of lookback period to use. I've modeled several and always try to keep things simple, the model I'm here is an average of 5, 10, and 15-days. Meaning I'm looking at the average daily range of the S&P 500 over 5-days, 10-days, and 15-days. When this is rising that means the S&P is seeing large shifts in price each day over 5 to 15 days. As you can imagine this figure is extremely high right now during this historical sell-off. Near the low or after the low, we want this figure to go down which tells us the market has begun to relax, it doesn't mean it's stop declining but it may have slowed the bleeding (so to speak) with less intraday volatility.

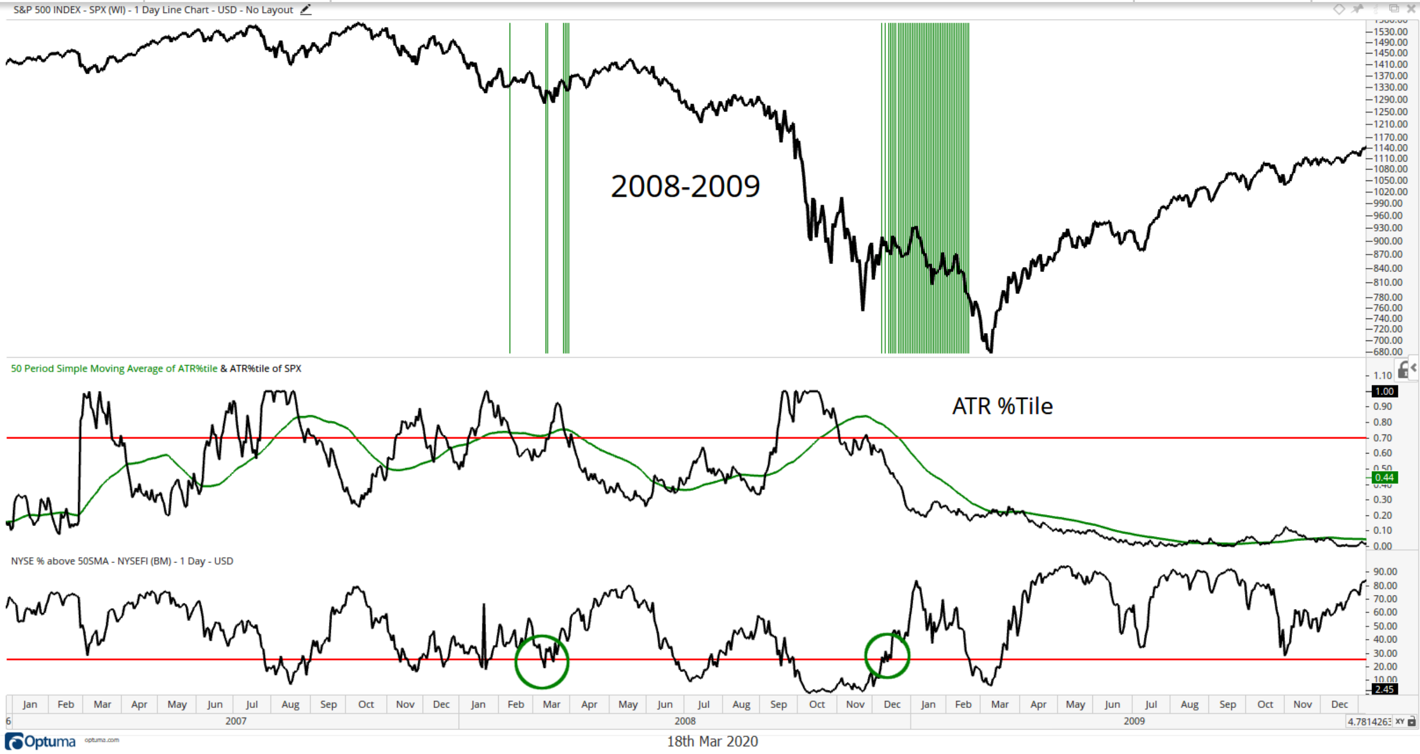
The Second:
We need to have individual stocks improve their trends. I mentioned this earlier, breadth is critically important. Again, there's several ways we can measure this. I quantify this through the percentage of stocks trading above their 50-day Moving Average. Ideally, I want to see 25% of the S&P 500 or NYSE trading back above their intermediate-Moving Average. By looking at the individual stock level and the amount that have begun to rise, we can get confidence that the potential future strength in the index itself is being supported by the individual components.

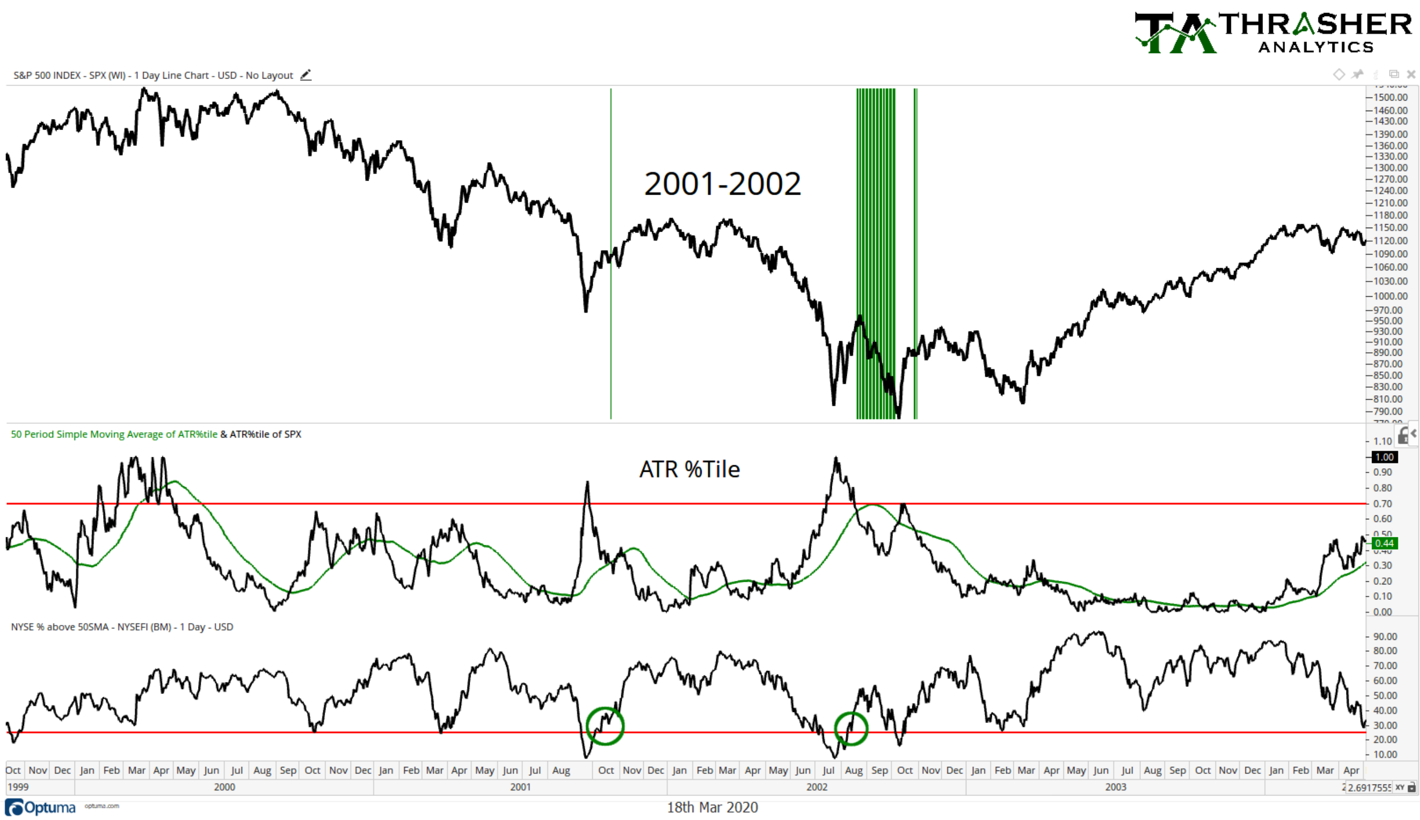
Combined:
Once we have both developments taking place then we know that trading is more orderly, there's less day-to-day volatility within the index along with stocks starting to break their down trends. You'll notice I didn't mention the virus. I don't pretend to have an analytical edge in epidemiology. During these two developments there may be (hopefully) news of improvement in the virus infection trends. What I'm focused on is price action, which will reflect the current headlines as improvements in the Coronavirus should lead to calmer trading activity and improvements in individual stocks.

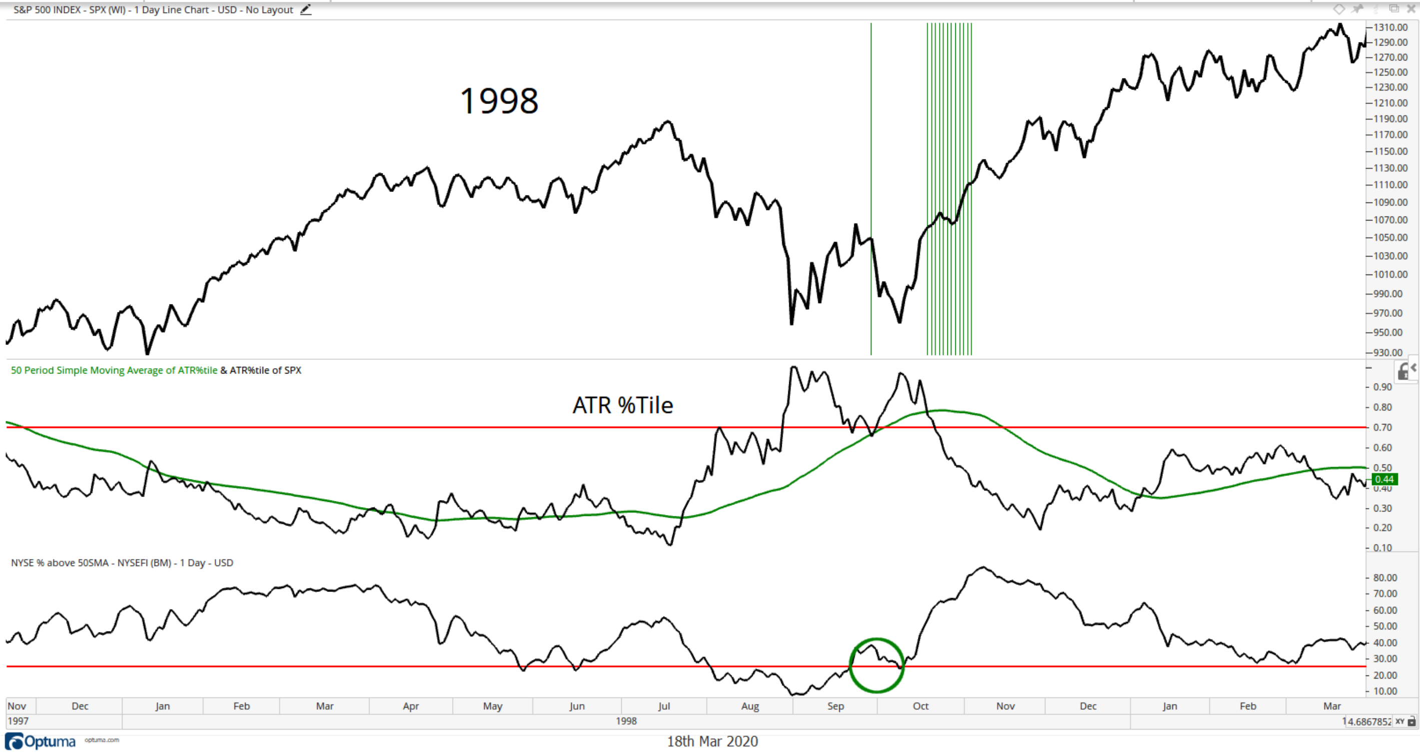
The example charts below show green bars when both criteria are met. I view this as my time to start looking at other data and see if there's further signs of confirmation that the markets proverbial fever has broken and is returning to health. Sometimes this occurs after the final low, sometimes just before. From here, I want to see price begin to confirm as well if it hasn't already. If I were to pick two periods in history that I think our current market most resembles, I would say 2011 and 1998, based on the shape of the decline and the macro backdrop (especially in '98) that we faced during those times.


S&P 500 INDEX - SPX (WI) - 1 Day Line Chart - USD - No Layout
2018
50 Period Simple Moving Average of ATR%tile & ATR%tile of SPX
ATR %Tile
NYSE % above 50SMA - NYSEFI (BM) - 1 Day - USD
Sep Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep
2017 2018 2019
Optuma
18th Mar 2020


THRASHER ANALYTICS
S&P 500 INDEX - SPX (WI) - 1 Day Line Chart - USD - No Layout
2010-2011
50 Period Simple Moving Average of ATR%tile & ATR%tile of SPX
ATR %Tile
NYSE % above 50SMA - NYSEFI (BM) - 1 Day - USD
Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar
2010 2011
Optuma
18th Mar 2020


S&P 500 INDEX - SPX (WI) - 1 Day Line Chart - USD - No Layout
2008-2009
50 Period Simple Moving Average of ATR%tile & ATR%tile of SPX
ATR %Tile
NYSE % above 50SMA - NYSEFI (BM) - 1 Day - USD
2007
2008
2009
Optuma
18th Mar 2020


THRASHER ANALYTICS
S&P 500 INDEX - SPX (WI) - 1 Day Line Chart - USD - No Layout
2001-2002
50 Period Simple Moving Average of ATR%tile & ATR%tile of SPX
ATR %Tile
NYSE % above 50SMA - NYSEFI (BM) - 1 Day - USD
1999
2000
2001
2002
2003
Optuma
18th Mar 2020



Of course I'll be updating you on these two factors as they develop. It's not a matter of if but when. We will come out of this bear market, the world is not ending! We can't know when but must respect the price action in front of us and be patience as the data improves, when it eventually does. Again, it's not meant to be a trading signal but as a sign that the market environment is showing signs of improvement.

Best Regards,
Andrew Thrasher, CMT

Important Reminder

None of the Content Distributed By Thrasher Analytics May Be Shared or Disseminated Without Prior Approval.